No. 10090

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

SAMUEL POORMAN, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

OPENING BRIEF FOR PETITIONER.

On Petition to Review Decision of United States Board of Tax Appeals.

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Petitioner pro se.

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Jurisdiction on Review.

Petitioner (hereinafter designated "Taxpayer") seeks a review by the United States Circuit Court of Appeals for the Ninth Circuit of a decision by the United States Board of Tax Appeals redetermining (in conformity with Respondent's prior determination), a deficiency in United States Individual Income Tax due from Taxpayer for the calendar (and taxable) year 1937 in the amount of $708.92 (less the portion of said amount assessed and/or assessable by reason of the inclusion in his taxable income of the sum of $18.45,—a loss by casualty, claim for which has been heretofore abandoned). The jurisdictional facts are alleged in the Petition herein [Tr. pp. 33-34], and bring the case within the provisions of the Internal Reve-

nue Code, § 1141 (a) and (b) [U.S.C.A., Title 26]. Said Petition for Review was filed on December 5, 1941 [Tr., p. 2] within three months after the rendition of the decision of said Board on September 12, 1941, as prescribed by § 1142 of the Internal Revenue Code [U.S.C.A., Title 26].

Jurisdiction of Board of Tax Appeals.

Taxpayer's income tax return for 1937 was made to the office of the Collector of Internal Revenue of the Los Angeles Division, Sixth District of California, in The City of Los Angeles within the Ninth Circuit. Taxpayer's Petition for a redetermination of such deficiency by the Board of Tax Appeals was filed on May 27, 1940 [Tr., p. 1], within ninety days after the mailing by said Collector to Petitioner, on March 27, 1940, of the Notice of Deficiency [Tr., p. 4, 9-12]. The jurisdictional facts are set forth in said Petition last mentioned [Tr., pp. 3-4]. Accordingly, under § 272 (a)(1) of the Internal Revenue Code [U.S.C.A., Title 26], said Board had jurisdiction of such Petition for redetermination.

Question Presented.

The question presented is whether the sum of $8,394.92 paid to Taxpayer by his *former* employer, Los Angeles Gas and Electric Corporation (hereinafter sometimes designated "Gas Company"), constituted *additional compensation* for *past services* (and therefore taxable income), or whether the same constituted a *gift* (and therefore to be excluded from gross income as exempt from taxation). Said payment and payments of like character were made by said Corporation to its former employees who, by reason of the sale of its electric properties to The City of Los Angeles, entered the employ of the City.

Statute Involved.

The statute under which such question arises is the Revenue Act of 1936, Sections 21, 22(a), and 22(b)(3). Those sections provide, in part, as follows:

> "Sec. 21. NET INCOME. 'Net income' means the gross income computed under Sec. 22, less the deductions allowed by Sec. 23.
>
> "Sec. 22. GROSS INCOME. *General Definition.*—'Gross income' includes gains, profits and income derived *from salaries, wages, or compensation* for personal service, of whatever kind and in whatsoever form paid, *or from professions,* vocations, trades, businesses, * * *;
>
> (b) *Exclusions from gross income.*—The following items shall *not* be included in *gross income* and shall be *exempt* from taxation under this title: * * *
>
> (3) *Gifts, bequests and devises.*—The value of property acquired by *gift,* bequest, devise or inheritance * * *;"

Decision and Opinion of Board of Tax Appeals.

The decision of the United States Board of Tax Appeals [Tr., pp. 32-33] in favor of Respondent (hereinafter designated "Commissioner") is based upon its Findings of Fact [Tr., pp. 15-25], wherefrom that Board in its Opinion [Tr., pp. 25-31] concluded that the payment in question was *not* an *absolute gift* but was *additional compensation* for *past* services. The Board so concluded notwithstanding "the Corporation [payor] saw fit to enter [on its books and in its income tax return] the payment made to [Taxpayer] and to the other [former] employees as *an expense item in the sale of its electric properties,* [with which] they, and especially he, *had nothing to do,*" upon the ground that Taxpayer "has *not* sustained his burden [of overcoming] the *presumption of correctness* attaching to [Commisisoner's] determination that the payment was *not* a gift * * * merely by proving * * * that it was *improperly treated* upon the books of the Corporation." In its opinion, the Board adds:

> "In other words, it was incumbent upon Petitioner *to prove* that the Corporation was *not discharging* some *obligation to him* by making the payment in question. The evidence indicates that the payments were made *to compensate the employees for their rights* under the 'Uniform Pension and Benefit Plan' *or to enable the company to withdraw the funds* which had been put up with the Insurance Company in connection with such plan. This, in our opinion, *was sufficient consideration to prevent the payments being absolute gifts.*" [Tr., pp. 30-31.]

Assignments of Error.

Taxpayer assigns as error herein:

(1) Said Board's finding and determination that said sum of $8394.92 constituted *additional compensation* paid to Taxpayer by his *former* employer for *past* services;

(2) Said Board's *failure* to find and determine that such payment was a *gift* to Taxpayer and non-taxable income;

(3) Said Board's finding and determination of the existence of a deficiency in income tax due from Taxpayer for the year 1937 by reason of such payment to him; and

(4) Said Board's *failure* to find and determine that there was and is no such deficiency. [Tr., pp. 35-36.]

Summary of Argument.

In outline, Taxpayer relies upon the following Points of Law and Fact:

(1) In its essence, the payment in question constituted a *gift* and therefore was nontaxable income. [Revenue Act of 1936, Sec. 22(b)(3); *Bogardus v. Commissioner,* 302 U. S. 34.]

(2) The designation of the payment by Taxpayer's former employer "as additional compensation" is negatived by the circumstances;

(i) When Taxpayer on January 25, 1937, was first notified by the president of Los Angeles Gas and Electric Corporation, the employer, of the fact and amount of the proposed payment to him, it was *not* designated as *"additional* compensation," but as the *"giving* of a bonus" that *"Pacific Lighting Corporation,* which held *all of the common stock* of the Los Angeles Gas and Electric Corporation, *had arranged* for." [Tr., pp. 40-41.]

(ii) The designation of the payment "as additional compensation, in *recognition* of the value of your past services," was first made in a circular letter addressed "To Employees About to be Transferred from the Service of Our Company" [Tr., pp. 45-47], dated January 25, 1937, a copy of which was received by Taxpayer only "after [he] had left the employ of the corporation." [Tr., p. 42.]

(iii) Although said payment was made by check, dated February 17, 1937, designating it as "additional compensation for services to and including January 31, 1937, in accordance with" said letter, nevertheless in the *employer's books,* as also in

its income tax return for the year 1937, the gross amount of *all payments of the same character* was carried into a special ledger account designated *"Sale of Electric Properties,* Suspense Account," wherein were set up *solely* the items of *receipts and disbursements* in connection with the employer's said *sale* of its electric properties, and the aggregate of said payments was treated, in both said book and said tax return, as one of the *"expenses of sale"* and *deducted,* in like manner with other items of such expense, *from the selling price* in order *to determine the taxable profit realized from such sale.* [Tr., pp. 59-65.]

(iv) Neither Taxpayer nor any other of the employees receiving payments of like character *had the remotest connection with the sale* of their employer's electric properties. [Tr., pp. 63 and 67.]

(v) Such payments were *not* charged as an *operating expense* of the business conducted by Taxpayer's former employer, either in the year in which they were made or as of any previous year, for the *reason* that they were "so distinctly *not* an *operating expense.*" [Tr., p. 63.]

(vi) Taxpayer was paid *in full* for his services *monthly* as they were performed, and each voucher check specified that it was *"in full settlement* [for] services as attorney during" the month covered thereby. [T., p. 41.]

(vii) After the termination of his employment, Taxpayer *did not perform,* and was *under no obligation to perform,* any service whatsoever for his former employer, *nor* was he *obligated* even to *enter* its *vendee's* employment.

ARGUMENT.

(a) Statement of Facts.

(1) For approximately 17 years prior to February 1, 1937, Taxpayer had been employed as an attorney at law by Los Angeles Gas & Electric Corporation, a corporation that, throughout such period, had rendered a public utility gas and electric service in Los Angeles, California, and in certain adjacent communities. [Tr., pp. 15 and 40.]

(2) On January 31, 1937, a sale of said Corporation's electric properties to The City of Los Angeles was consummated, and some 840 or 850 employees of the Corporation were transferred to the Department of Water and Power of The City of Los Angeles. Taxpayer was one of these, although he did not enter the employ of that Department until March 1, 1937. The employees so transferred constituted about one-third of the then personnel of the Corporation, which thereafter continued solely its gas business, and in May, 1937, it was consolidated by a merger with Southern California Gas Company. [Tr., p. 16.]

(3) For approximately 10 years prior to the termination of Taxpayer's employment by Los Angeles Gas and Electric Corporation, he had been engaged as its attorney exclusively in long drawn out and expensive litigation, *i. e.*, (i) two actions instituted by The City of Los Angeles to enjoin said Corporation's use of that City's streets for the distribution of gas and electricity, respectively, for any purpose other than lighting; and also (ii) one action instituted by the City of Pasadena to enjoin said Corporation's use of the streets of the city last named for the distribution of gas except for lighting. [Tr., pp. 40 and 67.]

(4) Said litigation with The City of Los Angeles ultimately led to a settlement of the controversy with it by a sale of the Corporation's electric properties to that City for $46,000,000.00 plus. With this settlement and sale, Taxpayer *had nothing whatsoever to do.* [Tr., pp. 40, 60-63, 67.]

(5) On January 30, 1937, Taxpayer was paid in full by Los Angeles Gas and Electric Corporation for all services by him rendered, and to be rendered, during the month of January, 1937. He had theretofore been paid in full by said Corporation for all services by him rendered, and to be rendered, prior to January 1, 1937. The checks by which such payments were made were identical in form with that for January, 1937, [Petitioner's Exhibit 1], the detachable voucher whereof reads as follows:

> "Statement of Account. *In full settlement of which payee has accepted* Los Angeles Gas and Electric Corporation check, annexed hereto: Samuel Poorman, Jr., January 30, 1937, services as attorney during the month of January, 1937,—$1,000.00. Payee will please detach and retain this statement." [Tr., pp. 16-17, 41, 44-45.]

(6) On January 25, 1937, Taxpayer was notified *in person* by A. B. Day, the then president of Los Angeles Gas and Electric Corporation, that his work with the Corporation was finished and that the attorney for the Department of Water and Power of The City of Los Angeles had asked that, "if there was anybody to be transferred from the Legal Department [of the Corporation] to [said] Department, [Taxpayer] should be transferred." In the course of this conversation, Mr. Day stated that *"Pacific Lighting Corporation* had *arranged*

for *the giving of a bonus* to the employees to be transferred to said Department" with the sale to the City of the electric properties. [Tr., pp. 40-41.]

(7) Pacific Lighting Corporation was the *holding company* of which Los Angeles Gas and Electric Corporation was the principal subsidiary. The holding company owned *all of the common stock* of such subsidiary, and *completely dominated* the management and control thereof; and at all times during Taxpayer's employment by the latter the *earnings of the subsidiary sufficed to cover several times its preferred stock dividends.* [Tr., p. 43.]

(8) At the interview between Taxpayer and Mr. Day on January 25, 1937, the latter did *not* make any mention that said bonus, for which *Pacific Lighting Corporation* had so *arranged,* was to be paid or given as additional compensation, but merely characterized it as *"given* in recognition of [Taxpayer's] fine work in [said street] franchise cases." [Tr., pp. 42-43.]

(9) Some time after January 25, 1937, Taxpayer received by mail, at his residence, a circular letter dated January 25, 1937, addressed "To Employees About to be Transferred from the Service of our Company," which contained the declaration: *"Arrangements have been made* to grant you *additional compensation* in *recognition* of the value of your past services. The amount of this payment will be based upon your present attained age, your length of service with the Company, and the rates of wages received during the period of employment; but this extra compensation will not be paid to employees whose 'employment date' is more recent than September 1, 1934." [Tr., pp. 21-22.]

(10) Taxpayer received the payment in question, $8,394.92, on or about February 19, 1937. The detacha-

ble voucher of the check by which this payment was made contains the following: "Additional Compensation for services to and including January 31, 1937, in accordance with the president's letter of January 25, 1937," [Petitioner's Exhibit 2]. This language appeared *only* on this and other checks of like character, all *salary checks* received by Taxpayer having on their respective vouchers the statement, as in Petitioner's Exhibit 1, "Services as attorney during the month" specified and covered thereby. [Tr., pp. 16-17, 23, 41-42, 44, 56.]

(11) On Taxpayer's United States Individual Income Tax Return for 1937, said amount of $8,394.92 was reported in Schedule H, *i. e.,* nontaxable income other than certain interest, as follows: "Bonus received from Los Angeles Gas and Electric Corporation after leaving its employ upon transfer of its electric system to The City of Los Angeles, (*not* having been paid or received *as a consideration for services rendered,* and the same constituting a *gift,* as held in *Bogardus v. Commissioner of Internal Revenue,* [302 U. S., 34]; 82 L. ed. 90), * * * $8,394.92." [Tr., p. 43.]

(12) The total of the payments of the so-called "additional compensation" was $475,546.32, which was charged to a ledger account of the payor designated *"Sale of Electric Properties,* Suspense Account," as a debit made up of two expense items. These two items represented two deposits in a special bank account against which checks in favor of the several transferred individual employees were drawn, and on each of the two vouchers covering these deposits appears the wording, *"Additional compensation for past services";* and in the *Corporation's* own *Federal Income Tax Return* for 1937, "so far as this item of *additional compensation* is concerned, it is *treated exactly*

as it runs through all of the records." On that return "the net income for excess profits computation" appears as $15,487,429.60, and "Schedule E, page 6, attached to the return, shows a *taxable profit* from the *sale* of electric properties of $13,360,895.75," which was carried over into Schedule A and became a part of said item of $15,487,-429.60. In Schedule E, the *expense of the sale* of said electric properties is given as $3,306,000.00, and "the items back of that *include this extra compensation,"* none of which is reflected in any other account of the Corporation. [Tr., pp. 23-24, 59-61, 61-62, and 65.]

(13) In the Corporation's books and also in its said Income Tax Return for 1937, the so-called "additional compensation" was made a "deduction" as against the *sale of capital assets,*—and *not* as a deduction of *expense incurred in its ordinary operations.* The book accounts and the Income Tax Return in respect of such *ordinary operations* were *"intentionally* set out *separate and apart from* the *profit* resulting from the *sale* of the electric properties." The so-called "additional compensation" was *not reflected* in the *ordinary operating expenses* of the Corporation covering any prior or other period of time; and for the tax year 1937 was *not entered* as a charge in the nature of *ordinary operating expense,* because "it was so definitely *not ordinary operating expense;* it would *never* have been made *but for the sale* of the electric properties or some other abnormal or extraordinary transaction." [Tr., pp. 61-63.]

(14) *No bonus or additional compensation* whatsoever was paid to the *employees retained* by Los Angeles Gas and Electric Corporation, and *no extra payment* other than that here in question was ever made by the Corporation to Taxpayer. [Tr., pp. 24, 62, 65.]

(15) *Taxpayer had nothing to do with the sale of the electric properties,* nor did any other employee of the Corporation who was transferred to the Department of Water and Power and to whom the so-called "additional compensation" was paid. [Tr., pp. 24, 40, 63, 66-67.]

(16) The characterization of the payments as "additional compensation" was determined upon after it was ascertained that the Corporation could not make suitable arrangements for the continuance by the Metropolitan Life Insurance Company of some sort of pension in favor of the recipient employees; but, in addition, "since we have mentioned the *tax angle,* that came into the consideration *to make the payment in such manner* as would be *considered* a proper *deductible expense* of the Corporation *as against the profit on the sale.*" [Tr., pp. 54-55, 64-65.]

(b) The Controlling Force of Bogardus v. Commissioner, 302 U. S. 34.

The hopeless conflict in the decisions that prevailed prior to *Bogardus v. Commissioner, supra,* (1937), was therein resolved and once for all set at rest by the Supreme Court; and the foregoing "Summary of Argument" and "Statement of Facts" brings the case at bar within its controlling authority.

Preliminary to our treatment of the *indicia,* in the case at bar, that the payment in question was a *gift,*—and *not* compensation,— a precise apprehension of the facts in the case cited and of their bearing upon the Supreme Court's ruling is essential.

In *Bogardus v. Commissioner, supra,* the taxpayer received $10,000.00 out of a total distribution, aggregating more than $600,000.00, made by Unopco Corporation to

persons who had theretofore rendered service as employees to Universal Oil Products Company, an immensely successful concern, the entire capital stock of which had been acquired by United Gasoline Corporation. In contemplation of such acquisition, Unopco Corporation had been organized to acquire certain of the assets of Universal Oil and its only business was the investment and management of these assets. *The former stockholders of Universal Oil became stockholders of Unopco with the same proportionate holdings,* but after United Gasoline acquired the Universal Oil stock none of them held any stock in either of those companies. After such acquisition Universal Oil continued to carry on the same business.

The then stockholders of Unopco proposed to show their *appreciation* of the loyalty and support of some of the employees of Universal Oil by making them a "gift or honorarium," and appropriate resolutions were adopted by them and by Unopco's Board of Directors. Some of the recipients had been in the employ of Universal Oil for many years. It was stipulated that neither Universal Oil nor United Gasoline was *under any legal or other obligation* to pay said employees any additional compensation, and that neither Unopco nor any of its stockholders, nor any stockholders of Universal Oil, was at any time *under any legal or other obligation* to pay any consideration whatever to said employees; that said payments were not made, or intended, as payment or compensation for any services rendered or to be rendered, or for any consideration given or to be given, by the employees to Unopco or its stockholders. *None of the three corporations or their stockholders ever made or claimed any deduction of these payments for Federal income tax purposes, and they were charged not to expense but to surplus account* on

Unopco's books. The statement accompanying the payments declared them to be made as a gift and gratuity, and, therefore, not subject to income tax.

The Board of Tax Appeals held the payments to be additional compensation and subject to tax. In reversing this decision, the Supreme Court rejected the view of said Board that such payments "may be at once 'gifts' under § 22, subdivision (b) (3) and 'compensation for personal service' under subdivision (a)," Revenue Act of 1928. [302 U. S. 39.] The Court said:

> "Such a view of the statute is inadmissible and confusing. The statute *definitely distinguishes* between *compensation* on the one hand and *gifts* on the other hand, the former being taxable and the latter free from taxation. The *two terms* are, and were meant to be, *mutually exclusive;* and a bestowal of money *cannot,* under the statute, be *both* a *gift* and a payment of *compensation.*" [302 U. S. 39.]

The Court then examines the evidence to determine whether or not the claim that the payment was a gift was genuine or fictitious, and, in support of the genuineness of the claim, points out these salient *indicia.*

(a) The recipients were never employees of Unopco or its stockholders.

(b) Universal Oil was not at the time connected with Unopco or its stockholders.

(c) Some of the recipients had not been in the employ of Universal Oil for many years, and one had never been an employee.

(d) Neither Unopco nor anyone else was under any *obligation* to pay the recipients any compensation.

(e) The payments *"were not made or intended to be made for services* rendered or to be rendered *or for any consideration* given or to be given by" the recipients to Unopco or its stockholders.

(f) *"If* the disbursements had been made by Universal Company, or by the stockholders of that company *still interested in its success and in the maintenance of the good will and loyalty of its employees,* there *might* be ground for the *inference* that they were payments of additional compensation. * * * But such an inference * * * *well might strain the realities in the light of the foregoing facts."*

(g) "The disbursements here were authorized and the burden borne by persons who were then strangers to Universal Company and its employees, under no obligation, legal or otherwise, to that company or to any of its present or former employees." [302 U. S. 40-41.]

The Court proceeds:

"There is entirely *lacking* the constraining force of *any moral or legal duty* as well as the *incentive of anticipated benefit* of any kind beyond the satisfaction which flows from the performance of a generous act. * * *

"The stockholders of the Unopco, having at the time no connection with the Universal [Oil] Company, but rejoicing in the fact of their own great good fortune, and *mindful of the former loyal support* of a number of employees of the Universal [Oil]

Company, and desiring to remember them 'in the form of a gift or honorarium,' resolved to make through the Unopco company the distribution in question. In doing so, they were moved, as Judge Swan said in his dissenting opinion below, to an act of 'spontaneous generosity.' We agree with this dissenting opinion of Judge Swan, and the dissenting opinion of Judge Morton in *Walker v. Commissioner, supra,* [88 Fed. (2d) 61], as stating the correct view of the matter." [302 U. S. 42.]

The Court notes as "the only facts which even seem to militate against this view," the following:

"(1) That the Unopco stockholders *had benefited* by the former services of the recipients;

"(2) That the stockholders at their meeting described the payment as a gift or *'honorarium;'* and

"(3) That the resolutions authorized the payments as a *'bonus * * * in recognition of the valuable and loyal services'* of the employees." [302 U. S. 42.]

These facts the Court meets as follows:

"1. Because the Unopco stockholders had *benefited* by the past services of the recipients, it by no means follows that the distribution in question was *not a gratuity.* It *nowhere appears* in the record that *full compensation* had *not been made* for these services. There would seem to be a natural inference to the contrary; and the inference is made determinate by the stipulated fact that no one was under any

obligation, legal or otherwise, * * * to pay any additional compensation. *There is no ground for saying that the benefit received and the compensation then paid for it were not equivalents.*"

2. Even if the word "honorarium" denotes a "*compensatory* payment," it is here coupled with the word "gift," which, as it does *not* include a *compensatory* payment, could not have been used to nullify the former expression.

3. The word "bonus" in the resolutions was used and is to be understood in the light of the intention, expressed at the stockholders' meeting, to make gifts. [302 U. S. 42-43.]

The Court adds:

"In *Rogers v. Hill,* 289 U. S. 582, 591-592, we held, following the dissenting opinion in the court below, that a bonus payment *having no relation to the value of services for which it is given* is in reality a *gift* in part. Certainly, where all the facts and circumstances in the case, * * * clearly show the making and the intent to make a *gift,* it *cannot be converted into a payment for services by inaccurately describing it,* in the consummating resolutions, *as a bonus.*

"Some stress is laid on the recital to the effect that the bounty is bestowed *in recognition of past loyal services.* But this recital amounts to *nothing more* than the *acknowledgment* of an *historic fact* as a *reason* for making the gifts. *A gift is none the less a gift because inspired by gratitude for the past faithful service of the recipient.*" [302 U. S. 44.]

(c) Indicia in the Case at Bar That the Payment Was Not Compensation But a Gift.

The correspondence between the salient facts of the case at bar and those upon which the Supreme Court based its decision in the *Bogardus Case, supra,* is striking. That the payment to Taxpayer here in question was in its essence a gift and not compensation will be apparent upon a consideration of the following circumstances:

(1) *Taxpayer rendered no service whatever in connection with the sale* of Gas Company's electric properties *nor in any of the negotiations therefor.* Although an attorney at law, whose training and specialized experience might have made him available in that connection, he was as totally dissociated from the transaction as was any lineman or other operating employee of Gas Company.

(2) Gas Company's characterization of the payments to transferred employees as "additional compensation *in recognition* of the value of your *past services,*" is contradicted by its book accounts and also by its income tax return, wherein that Company did *not* treat such payments as an *operating expense* (which alone they could be if *in fact* "additional *compensation*"), but as a *unique* expense *incurred* in the making of the *sale of its electric plant and business.* As *none* of the recipient employees had *ever* performed *any services* whatsoever in connection with such *sale,* and had never been,—as indeed they *could not* have been,—paid *any* compensation *initially* in that behalf, it was simply (and equally) *impossible* to pay them "*additional* compensation" therefor.

(3) Gas Company's president, in notifying Taxpayer of the termination of his employment, stated that "Pacific Lighting Corporation [the holding company] had *ar-*

ranged to *give* a bonus" to *this* Taxpayer *"in recognition of,"*—and *not* as *compensation* for,—"his fine services *in the franchise cases,"* the litigation on which Taxpayer had been exclusively engaged for some ten years and by which *his participation* in the negotiation or consummation of the *sale* of the electric properties would have been *rendered impossible.* [Tr., pp. 40-41, 44, 66-67.]

(4) Taxpayer's employment was at Gas Company's will and he was paid in full for his services *monthly* as they were performed. Each salary check delivered to him (including the closing check delivered *after* his said conversation with Gas Company's president), set forth that it was *"in full settlement* [for] *services* as attorney *during" the month* covered thereby and specified therein. [Tr., pp. 41 and 44.]

(5) The payment to Taxpayer had been *"arranged for"* by Pacific Lighting Corporation, *the holding company which held all of the common stock* of Gas Company; and, as the net profits of Gas Company had at all times sufficed to cover several times its preferred dividend requirements, the payment was, in effect, *a donation out of funds equitably belonging to Pacific Lighting Corporation* and could *not* in anywise affect preferred stockholders. [Tr.. pp. 40, 43-44.]

(6) The payments to the transferred employees were *not* made for services *to be rendered* either to the Gas Company, or to the Department of Water and Power of The City of Los Angeles, or otherwise. [Tr., pp. 44-45.]

(7) Said payments were *not* made *on condition* that the respective recipients should *enter the employ* of said Department of Water and Power, and, indeed, Taxpayer did *not,* for a month after the sale, *enter that employment.* [Tr., pp. 40-44.]

(8) In the making of said payments, there was *no incentive to maintain the good will and loyalty* of the recipient employees, for neither Gas Company nor Pacific Lighting Corporation had *any interest* in the *continued success* of the business transferred to the City or in the *maintenance of such good will and loyalty.*

(9) The *sale* was a very *advantageous* one, not only because it *terminated* long drawn out and costly *litigation* respecting both the electric and the gas franchises of Gas Company in Los Angeles, but because it resulted in a *net profit* to Gas Company, as set forth in its Income Tax Return, of $13,360,895.75 after all deductions (including $3,306,000.00 *expenses of sale,* of which the *$475,546.32 paid to the transferred employees constituted part*). This was a profit of approximately *forty per cent* (40%). [Tr., pp. 60-63.]

It requires no argument to demonstrate that the payment to Taxpayer could *not* have its *essential character* changed by Gas Company's denomination of it as "additional compensation." In fact, Gas Company's action in this behalf was *self-frustrated.* Even if a payment may be "additional compensation" for *past services* which have *already* been compensated *in full,* it cannot be either *"additional* compensation," or *compensation at all,* if it purports to be in consideration of services in which the recipient had *never been engaged,* to which he had *never contributed,* and for which he *could not,* therefore, have received any *initial* compensation. Even in the circular letter addressed by Gas Company to the recipient employees, the payment was characterized as "additional compensation *in recognition of the value* of your past

services,"—the use of the italicized words (instead of some such expression as "in *consideration* of your past services"), having the aspect more of a recital of the *motive* by which the payment was actuated than of a *legal consideration* therefor. When we find such a statement of *motivation* in a mere *circular* letter (of which Taxpayer received a copy only *after* being advised by Gas Company's president that the payment *he* was later to receive was "in *recognition* of [his] fine work in the *franchise cases*"), the only natural conclusion is that the words italicized in the phrase above quoted from that letter were *not* intended *to contradict* what the president had orally stated to Taxpayer, but rather to *confirm,* in general terms, that oral recital of the *historic fact* constituting the *motive* for paying him a sum of money *to which he had no legal or other claim* and which Gas Company was under *no legal or other obligation to pay.*

It would ill become Taxpayer, as the recipient of his former employer's bounty, to animadvert upon anything done by that employer in connection therewith. *If* the payment in question *was* properly *an expense of the sale* of Gas Company's electric properties and, therefore, *deductible from the gross selling price* in order to determine the *profit* realized from that sale, then it could *not* have been *"compensation"* to Taxpayer, for he had *never* performed *any* service in connection with such sale; and even if it were possible to conceive of *"compensation"* in the absence of anything savoring of a *consideration* therefor,—*i. e.,* something paid *in return* for services,—then *this* payment could not have been *"additional* compensation," for Taxpayer had not been paid any *initial* compensation [?] in that behalf. Such compensation as he *had* received during his employment by Gas Company was

an *ordinary operating expense* (and so treated by Gas Company), incurred in carrying on the normal or ordinary business of a public utility gas and electric company. He *was not hired* for any *other* purpose and *was never injected into* the matter of the *sale* of the electric properties,—an activity intrusted to attorneys in general practice retained for that special purpose, and by Mr. Houghton characterized as an "abnormal or extraordinary transaction" [Tr., p. 63].

Indeed, during the very period in which the negotiations for the sale were carried on, Taxpayer was so *exclusively* engaged in resisting the attacks of Los Angeles and Pasadena upon Gas Company's franchises that he would have had *no opportunity to participate* in that "abnormal transaction" [Tr., pp. 63, 66-67], even if Gas Company had desired him to do so, and obviously it did *not* so desire. Taxpayer was *never consulted* relative to the sale or any matter related thereto. Moreover, Taxpayer had no connection with any conference respecting the transfer of employees by Gas Company to the City, or respecting the payments to be made them [Tr., p. 64]; nor was he consulted in respect of Gas Company's 1937 income tax return; nor did he have any connection with the merger of Los Angeles Gas and Electric Corporation with Southern California Gas Company [Tr., p. 65]. In short, once the franchise litigation got into its stride, after the troubles of The City of Los Angeles growing out of the bursting of the St. Francis Dam in 1927 [? 1928] had been in some measure adjusted, Taxpayer handled *none* of the general or other legal affairs of Gas Company. [Tr., p. 67.]

(d) The Board's Attempted Distinguishment of Bogardus v. Commissioner, 302 U. S. 34, and Taxpayer's Answer Thereto.

The Board of Tax Appeals attempted to distinguish the case at bar from *Bogardus v. Commissioner, supra.* Next hereinafter we have indicated the several points in this behalf made in the Board's Opinion, appending to the statement of each thereof Taxpayer's answer to the same.

(1) Non-existence *Versus* Existence of Employer-Employee Relationship.

Board's Opinion: In the *Bogardus Case,* the "recipients of the bounty * * * were never employees of the [payor] company or any of its stockholders"; while Taxpayer in the case at bar had been with his fellow employees in the employ of Gas Company "until the sale of the properties to the City." [Tr., p. 26.]

Answer: In its essence, payment to Taxpayer was made out of assets belonging to Pacific Lighting Corporation, the holding company of the nominal payor Gas Company, and Taxpayer had never been in the holding company's employ or in the employ of any of its stockholders. Despite the terms of the circular letter and the check characterizing the payment as "additional compensation," Taxpayer was *specially advised* by the president of the Gas Company that the payment *to him* "had been *arranged for" by the holding company,*—not as "additional compensation,"—but "in *recognition* of his fine work in the *franchise cases."* Unquestionably, such recognition *motivated* the payment to Taxpayer, but this is very far from making it "additional compensation" for all his past services, approximately one-half of his period of employment having antedated the commencement of the fran-

chise cases. Taxpayer's defense of Gas Company in the suits to prevent its use of the public streets for the distribution of gas and/or electricity was for the purpose, and had the effect, of enabling Gas Company *to continue* its operations,—and *not at all* to effect *a sale* of its electric properties, a result brought about by the *highly profitable offer* therefor by the City induced by its desire *to prevent such continuance* of Gas Company in the business.

(2) Payment as a Solatium *Versus* Payment on a Moral Consideration.

Board's Opinion: In the *Bogardus Case,* "neither the [employer] nor anyone else was under any obligation, legal or otherwise, to pay any of the recipients * * * any salary, compensation, or consideration of any kind"; whereas Gas Company "was at least under a *moral* obligation to the employees whose services were being terminated through no fault of theirs by reason of the loss that that termination visited upon such employees of the benefits they would *otherwise* have been entitled to under the employer's "Uniform Pension and Benefit Plan."

Answer: By the terms of the Pension and Benefit Plan, Gas Company reserved "the right to *discontinue* or change the Plan at any time," and it was stipulated that neither the adoption of the Plan nor any action taken thereunder by the Benefit Committee "shall be construed as giving to any officer, agent, or employee of the Company *the right to be retained* in the service, *nor shall any employee, after termination of service, have any rights whatsoever hereunder, enforceable either at law or in equity,* except [under the] 'employee options upon termination.'" These options were (a) either "to *leave* [the *employees'*] *contributions* with the Insurance Com-

pany, or *to continue his contributions* to the Insurance Company," and in either case to receive therefrom a monthly income for life from normal retirement date, *to the extent provided by such contributions* with interest [Tr., pp. 49-50]; and (b) *"to convert,* within 31 days after termination of service, *his death benefit into any of the life insurance policies* issued by the Insurance Company, term insurance excepted, *at the rate applicable* to his * * * attained age and class of risk *at such termination."*

It is obvious, therefore, that there was *owing to Taxpayer,* whose service was terminated, *no obligation of any kind* that could serve as a legal or moral consideration for the payment received by him, but, on the contrary, that the same was *wholly spontaneous* on the part of his employer or, rather, on the part of his employer's *sole common stockholder.* Note further that the employees *could not be deprived* of these *options* by the employer, and that the payments to the several transferred employees were made *irrespective of the manner* in which the individual employee *exercised such options,*—a matter of indifference to the employer. In other words, the transferred employees *lost nothing* upon their transfer *that was assured to them* by the Uniform Pension and Benefit Plan, that contingency having been *explicitly provided for* in the Plan and *having operated precisely as provided for.* What the transferred employee *did lose* was the *position* that he had theretofore occupied with the *prospect* of ultimately receiving a pension *contingent upon non-termination* of his employment *before* the specified age of *retirement.* The testimony of Mr. Houghton makes it clear that the payment to Taxpayer and his fellows *was motivated* by the consideration of this *loss of a prospective contingent*

benefit, but this is very far from making such loss a *consideration* for the payment. It was a mere *solatium* if ever there was one.

In the opinion below, it is said "the evidence indicates that the payments were made to *compensate* the employees for the *loss of their rights* under the 'Uniform Pension and Benefit Plan' *or to enable the Company to withdraw the funds which had been put up with the Insurance Company in connection with such Plan.* This in our opinion, was sufficient *consideration* to prevent the payments being absolute gifts." [Tr., p. 31.] Apart from what we have just said in respect of the employer's *motivation* as being the employee's loss of position, and distinguishing such *motivation* from a legal or moral *consideration* for such payments, we note that the *other* suggested purpose of the payment,—namely, "to enable the company to withdraw the funds which had been put up with the Insurance Company,"—could not *possibly* constitute a consideration *except as between the employer and the Insurance Company.* It did not *move* from the several *employees,* and was totally *unconnected* with any *service* that they had theretofore rendered or were thereafter to render for the employer or anyone else.

(3) The Charge of Payment on Payor's Books to Surplus *Versus* Expense.

Board's Opinion: "In the *Bogardus Case,* the payments were charged 'not to expense but to surplus.' In the instant proceedings, the payments were charged to expenses of the sale of the electric properties," and "the charge could properly have been so classified *only* if it had been *necessary* for the Corporation to make the payments *either to fulfill an obligation * * * or to regain pos-*

session of some of the money which had been put up [by it] with the understanding it would 'be used for employees' benefits and for no other purpose.'" [Tr., p. 28.]

Answer: The payments could *not* have been made *to fulfill an obligation,* moral or otherwise, in respect of the *"expenses" of the sale* of the electric properties, for *none* of the payees had rendered the *slightest service* in that connection; and, as already pointed out, if the employer made the payments to *regain possession of money* that *it* had put up with the Insurance Company on account of the employees' contingent pensions, the obtaining by the employer of the money in this manner obviously was *not in consideration of the payees' services* and could not constitute "additional compensation" therefor.

(4) Payor's Designation of Payment as "Gift" *Versus* "Compensation."

Board's Opinion: In the *Bogardus Case,* the payments were referred to as a "gift or honorarium," whereas in the case at bar they were designated as "additional compensation."

Answer: To Taxpayer Mr. Day declared, before the circular letter was sent out, that the payment *to him* had been *arranged for* by Pacific Lighting Corporation (*the holding company*), as "the *giving* of a bonus." This designation of the payment as a *gratuity* was borne out by his further statement, that it was "in *recognition* of Taxpayer's fine work in the *franchise cases,*" and also by the treatment of *all* of the payments, both on the employer's books and in its income tax return, as "expenses of the sale of its electric properties," with which *none* of the payees *had anything to do.* If, by *first* inducing the

recipient employees, in *their* individual income tax returns, to treat the payments as "additional *compensation*" for their *actual* past services, and by *thereafter* classifying them, on its books and in its *own* tax return, as *expenses of the sale* of its electric properties in which *they* rendered *no* service), the employer succeded in pulling the wool over the eyes of the Collector of Internal Revenue in order to induce him to allow such payments as a *deduction* from *its* gross income, it perpetrated a wrong from which it should not be permitted to profit as it *has* done—*i. e.,* by imposing on the recipients a burden of taxation with which they were *not* chargeable and thus *escaping* the corresponding portion of *its own income and excess profits taxes.*

(5) The *Ultra Vires* Aspect of Gifts.

Board's Opinion: In the case at bar, " 'if the directors [of the employer] *could not give away* this sum, and the books of the corporation show that it was *not* given away, it must be presumed that the payment was *not a gift.*' " [Tr., p. 29.]

Answer: In its essence, the gift was made, *not* by the employer, but out of assets the equitable title to which was in Pacific Lighting Corporation, the holding company. Not only did Mr. Day say to Taxpayer that the payment had been "arranged for" by the holding company, but in the circular letter addressed by him to the transferred employees it is stated that *"arrangements have been made* to grant you additional compensation *in recognition* of the value of your past services." [Tr., p. 21.] To state that such "arrangements have been made" is far more consonant with Mr. Day's oral statement that the

holding company had made *arrangements* for payment *through the subsidiary* than it is with action taken *independently* by the subsidiary. A payor acting in its own right would declare *its purpose to make* the payments in question, and not that *"arrangements had been made"* in that behalf (circular letter), or that the *holding company* "had *arranged* to pay a *gift* or bonus" (conversation between Taxpayer and Mr. Day). Of course, the *verb* "arrange" could naturally have been used in the circular letter, but if the "arrangement" had been that of *Gas Company itself,* and not of its holding company, the natural form of the clause employing that verb would have been,—"the *Corporation* [Gas Company] has *arranged* to grant you additional compensation."

(6) Taxpayer's Burden of Proof.

Board's Opinion: Taxpayer "has not sustained his burden merely by proving—if in fact he has proved—that [the payment] was *improperly treated* on the books of the Corporation [for] it was incumbent upon [taxpayer] *to prove* that the Corporation was *not discharging some obligation to him* by making the payment in question, [and] the evidence indicates that the payments were made *to compensate the employees for their loss of rights* under the 'Uniform Pension and Benefit Plan' *or to enable the company to withdraw the funds* which had been put up with the Insurance Company in connection with such Plan." [Tr., p. 31.]

Answer: The position taken by the Board in the sentence last quoted has already been sufficiently answered. As for the statement casting doubt upon Taxpayer's *proof* that the payment was *improperly treated* on the books of the Corporation, we submit that the proof in this behalf

established that fact beyond controversy. Both Taxpayer and Mr. Houghton testified that *neither Taxpayer nor the other transferred employees ever performed any services* in connection with the *sale* of the employer's electric properties. The payments, therefore, *could not properly be treated as they were* on the books and in the income tax return of the employer as an "expense" of such *sale.* None of the *retained* employees received any such payment and they had exactly as much to do with the sale of the electric properties as the *transferred* employees,—that is to say, *absolutely nothing.* On the other hand, if the payments were "additional compensation," it would have been properly an *operating expense;* but when Mr. Houghton was asked why it was not so treated on the books of the company and in its income tax return, he said that it was because "it was *so definitely not* ordinary *operating expense;* it would *never* have been *made* except for the *sale* of the electric properties or some other *abnormal or extraordinary transaction.*" [Tr., p. 63.] That is to say, it was *not* an operating expense *at all;* but *as compensation* of any kind for the only type of services performed by the payees,—*i. e.,* services *not* connected with the sale but with ordinary operating utility services, —it could *only* have been an *ordinary operating expense.*

In this passage of its opinion, the Board of Tax Appeals places itself in a dilemma. If the payments *constituted* an *operating* expense, they were *improperly treated* on the books and in the income tax return of the employer; while if they were *not* an operating expense, they were *correctly so treated.* But if they were correctly so treated,—namely, as an expense of the *sale,*—they *could not* constitute *compensation* to Taxpayer and the other payees, respectively, because none of them had *done any-*

thing in connection with the sale, and one simply *cannot* be *compensated* for *nothing*. As the payments could *not* constitute *compensation at all* to *them* for *sale* services rendered *by others,* by the same token, they could not constitute *"additional* compensation," there being no *original* "compensation" to be augmented. Since, in the concept of "compensation for personal service" there is inherent the element of a *consideration* for the "compensation," and as the distinguishing characteristic of a "gift" is the *absence* of any consideration therefor, the two expressions are of necessity mutually exclusive. The noun "compensation" comprehends the idea of something moving,—usually an equivalent in value,—from the person *compensating* to the one *compensated, i. e.,* a legal consideration.

Taxpayer's employer first advised him that the prospective payment was a "gift" "arranged for" by its *sole common stockholder*. Later, this payment was, in the Day letter and in the voucher check, denominated "additional compensation for past services." Although Taxpayer received said letter some little time after the date that it bore, the check was issued twenty-three days after the date of the letter and contemporaneously with such issuance it was entered in the employer's books as "expense of sale" of its electric system. Still later the employer, *under oath* in its income tax return, claimed the aggregate payments of the same character as a *deductible* "expense of [said] sale." Now, if *no consideration* moved from Taxpayer to the employer *in connection with such sale,* it could not be otherwise than a gift in the absence of further evidence of *intent*. The only other such evidence is the characterization of the payment as *"additional* compensation *for past services"* in the Day letter and the

check. This, *if it stood alone,* would negative the idea of a gift; *but it does not stand alone.* The book entries and the income tax return *allocated* the payment *to a particular transaction* in which Taxpayer was *not employed* and in which he rendered *no service;* it was a transaction handled *entirely by outside attorneys.* The falsity of this allocation *not being apparent* on the *face* of either, the generality of the allocation in the Day letter and the voucher check would lead one with access to *all* the writings, *but without further information,* to only one conclusion,—namely, that the *"past services"* referred to in the *letter* and in the *check* were the *same services specifically allocated* to the *sale* in both the *book entries* and the *income tax return.*

Although the character of a payment by an employer to an employee is a matter of *intention,* Mr. Day's conversation left no doubt in Taxpayer's mind but the intent here was to make him a "gift" in *"recognition"* of satisfactory work done in the *franchise cases.* A payment either is a gift, or it is not. If there is a *consideration* for it, it is *not a gift* of any character; if there is *no* consideration, it *cannot be anything but a gift.* The effect of the employer's characterization of the payments as "additional compensation" is nullified by the other and contradictory *indicia* of the employer's intent in making the same above discussed.

In short, the payment was earmarked by the employer, first as a "gift," and then as "expense of sale" of its electric system. On the records that would be scrutinized by taxing authorities, it was given an appearance calculated to induce their allowance of the same, without inquiry, as a *deduction* from gross income. Again, in the circular letter and in the checks the payment was declared to be

"extra compensation." Why this characterization was adopted is rendered clearer than the light of day by Mr. Houghton's testimony that *"the tax angle"* was given consideration in phrasing both letter and checks, and that it was accordingly determined to style the payments *"additional* compensation" in order "to make the [aggregate] payment in such manner as would be *considered* a proper *deductible expense* of the corporation * * * *as against the profit on the sale."* [Tr., pp. 64-65.] Considered by whom? Not by the Corporation,—for it was the moving party and knew the true facts,—but by the Commissioner of Internal Revenue when he came to auditing the Corporation's income tax return. However, this treatment of the payment as an expense of the sale of the Corporation's electric system, while giving it the *aspect* of a *deductible* expense, *definitely tied it down to a specific transaction* in which Taxpayer and the other transferred employees had *no* part and performed *no services.* Thus, the Corporation's effort in designating the payment as "extra compensation" was *self-frustrated,* for if truly such, it should have been entered on its books and in its income tax return as an *operating expense.*

If the Corporation had adhered to what was indicated in the Day letter and in the checks (which were matters of some notoriety), it would have returned these payments for income tax purposes as an ordinary *operating expense* for the taxable year 1937. Instead of so doing, it adopted the wholly inconsistent position, in the relative secrecy of its books and its income tax return, of *divorcing* these payments from its *ordinary operations* and treating them as an "extraordinary" and unique expense "incurred,"—a verb connoting an *obligation* to pay,—*in effecting the sale* of the entire capital assets of its electric system to the City.

(e) Even If Consistent With Its Other Acts, the Payor's Designation of the Payment as Compensation Could Not Alter Its Essential Character.

The payor could not, merely by characterizing its payment to Taxpayer as "extra compensation," make it such for *any* purpose if, in fact, there were *no past services* constituting the *consideration* therefor. Similarly, the payor could not, by treating such payment as an *original expense* incurred for services rendered in effecting the sale of the electric system theretofore operated by it as part of a combined gas and electric business, *make* it such *expense,* if in fact *no such services* had been rendered. Further, Taxpayer and the other employees of Gas Company transferred to the City's Department of Water and Power had rendered services (Taxpayer, for some 17 years) in the ordinary run of that Company's going utility business. Taxpayer's services were in his professional capacity, and for some nine years he had been *exclusively* engaged in defending the Company in franchise cases,—two *gas* and one electric,—the whole object of which defense was to *preserve* its status as an operating gas and electric public utility through the establishment of its right to use the streets of The City of Los Angeles for the distribution of electricity *and also gas,* and to use the streets of the City of Pasadena for the distribution of *gas* only. With the sale of the electric system went the Company's electric franchise and its means of further operating at all as an electric utility,—the very thing that for nine years Taxpayer *had succeeded in avoiding.* No wonder he was not taken into the Company's confidence in respect of such sale or called upon to render any services in that connection. No wonder it was handled by attorneys who were not salaried employees of the Company, but were specially retained for that purpose. To

permit Commissioner now to assert that what, on the Company's books and in its income tax return, it declared to be an *expense incurred in effecting that sale,* was *not* such, but was, in truth and in fact, "extra compensation" paid to employees transferred to the vendee with the electric system,—to wit, for *past* services rendered by them in the *ordinary operations* of the Company *in which alone* had *they* served and which *had nothing to do with the sale,*—would be to stultify the Company and to substitute for its *intention,* as thus manifested, the wishful thinking of Commissioner to the contrary.

In this connection, it is to be remembered that *no extra compensation* was *ever* paid to the employees *retained* by Gas Company. Obviously, in a body of some 2500 employees, it is *not* within the range of *possibility* that *only* the 840 who were transferred to the City had ever performed services *sufficiently meritorious* to be accorded *extra compensation* therefor. Moreover, Taxpayer and many of the other transferred employees had been employed and rendered service,—*not* exclusively in the operation of Gas Company's electric system,—but in the gas department as well,—*e. g.,* meter readers, collectors, clerical employees, solicitors, *etc.* Although the payments in question were made to employees within this category upon the *same basis* as were the payments to those who were employed *exclusively* in the *electric* department, at least one-half of the activities of the *former* were in the *gas* department for which the *latter rendered no services,*—a circumstance further indicative of the *lack* of any *relationship* between such payments and the *ordinary operating expenses* of the employer, and bringing into relief the differentiation made between retained employees and transferred employees who had *served in both departments.*

(f) The Payor's Purpose Underlying Its Contradictory Treatment of the Payments to the Transferred Employees.

In making the payments to the transferred employees, Gas Company found itself in a dilemma. It desired to *recognize,* by substantial payments, the *past services* of such employees. As we shall presently point out, the several amounts of those payments *were not based* upon any *evaluation* of those services, but upon a rule of thumb having only an *indirect relation* to the *value* thereof, and *no relation at all* to any *difference* in such value as between the several employees. There originally accompanied this desire, or subsequently developed, a purpose to take advantage of the payments in question as a deduction for income tax purposes. If the payments were truly "extra compensation," they were properly deductible as an *operating* expense of the payor *only* for the year 1937 in which they were made, and it was unnecessary,—indeed, would have been improper,—for Gas Company to open up its books for the previous years in which the several payees had been employed.

There is no legitimate, or even plausible, explanation in the evidence why such payments, if in fact *"extra* compensation," were *not* entered on Gas Company's books for 1937 and in its income tax return as an *operating* expenditure made in that year, or why they were instead treated on those very books for 1937 as an *expense of the sale deductible* from the *gross selling price* of the electric system to determine the profit realized. However, if any treatment of the payments in this manner was to escape questioning by the Commissioner of Internal Revenue (and, perhaps, by the Railroad Commission and the Franchise Tax Commissioner of California), it was es-

sential that *none* of the *transferred employees* should *claim* his payment to be a *nontaxable gift.* Accordingly, the expedient was adopted,—notwithstanding the entries on the payor's books and in its income tax return (to which the payees had no access),—of advising *them* by circular letter that the payments constituted "additional compensation for past services." Every transferred employee (except Taxpayer) took that letter and the voucher check at face value, and treated his payment as taxable income. Taxpayer, however, was not similarly lulled into unquestioning acceptance of this (to him) *belated* representation,—obviously, because of Mr. Day's *contrary declaration* (made to *him* and to *no other* employee), that *his* payment was a *gift "arranged for"* by the payor's *sole common stockholder;* and, accordingly, the whole transaction was brought to light herein.

(g) As the Payment to Taxpayer Was Neither Extra Compensation for Past Services Nor Compensation at all for Services in Effecting the Sale of the Electric System, It Could Only Have Been a Gift.

Gas Company has, by its book entries and its income tax return, effectually closed the door upon any possibility of claiming that its *intent,* in making the payments in question, was to grant *"extra* compensation" for *operating services* in the past rendered by *operating employees,* and thus Commissioner's basic point is eliminated from the case. By the same token, it is open to the Commissioner of Internal Revenue successfully to attack that return as erroneous, and thereupon to resist any effort by Gas Company now to treat those payments as an *ordinary operating expense.* It necessarily follows that the payments, which in the Commissioner's dealings with

the payor, must be treated *neither* as an *expense of the sale* in question *nor* as an ordinary *operating expense,* but as a *gift* (the only remaining alternative), must be herein treated in precisely the same way.

(h) Additional Authorities Illustrative of Facts Characterizing as Gifts Payments by Employer to Employee.

Despite the foregoing discussion of *Bogardus v. Commissioner, supra,* and of the facts in the case at bar demonstrative of the controlling authority of the case cited, a brief further reference to certain of the decisions will be illustrative and helpful.

In *Jones v. Commissioner,* 31 Fed. (2d) 755 (C.C.A. 3rd Cir., 1929), stockholders, who had substantially the same holdings in two affiliated corporations employing the same administrative staff, joined in selling their stock to other parties for some $3,000,000.00. This sum was deposited for them with a trust company which, by their consent, disbursed the same in defraying the expenses of such sale, in distributing a total of $300,000.00 to the employees constituting such administrative staff, and in allotting the balance *pro rata* to the stockholders for their stock. The Court, in holding said $300,000.00 to be "a nontaxable gift", said:

> "The situation was that an unexpected good sale was being made of the coal, railroads, and mines. The administrative staff had been long employed, and it was felt that *with the change of ownership they would lose their positions.* It was at first thought they should and could be paid something by the companies, but it was determined the *directors* could not *gratuitously* dispose of the corporation's assets at the expense of the stockholders, *for,* as found by the

> Tax Board, *none of these employees had anything whatever to do with securing a purchaser for the properties.* But when later the stockholders individually, and *without obligation* on their part, *or any consideration* then or theretofore received or rendered them, chose, *in recognition of the past faithful work of the staff,* to *gratuitously* give them this financial recognition, and in doing so took from their own pockets and not from the assets of the companies, we are clear *the gratuity thus bestowed was a gift,* * * *."
>
> 31 Fed. (2d) 755-756.

In the case at bar, the essential facts are in practical identity with those treated as controlling in the case last cited. We note this parallelism as follows:

(1) A sale was being made of Gas Company's electric properties which resulted both in a *large profit* and also in the *settlement of litigation* that had not only been expensive but had *threatened its very existence* as a public utility furnishing (except for lighting) either gas or electricity in Los Angeles or gas in Pasadena.

(2) It was realized by Gas Company and by Pacific Lighting Corporation, its sole common stockholder, that approximately one-third of the former's personnel,—many of whom had been long so employed,—would inevitably lose *that* employment, and it was obvious that they either might not be employed, or (if employed) might not be retained, by the City.

(3) It was first thought that Gas Company might be able to make arrangements with Metropolitan Life Insurance Company for some sort of pension for the employees with whom its relations were thus to be severed, but this was found impossible.

(4) As *none* of these employees *had anything whatever to do with negotiating or effecting the sale,* and as Gas Company could not *gratuitously* dispose of its assets at the expense and without the consent of Pacific Lighting Corporation (the sole stockholder to be affected), that holding company "without *obligation* on its part, *or any consideration* then or theretofore received or rendered [it], chose, *in recognition of the past faithful work* of the [employees affected by such sale], to *gratuitously* give them this financial recognition" by *"arranging"* for the disbursements through Gas Company, and by so doing, in effect "took from its own [treasury] and not from the assets of [Gas Company]" the funds necessary to make the disbursements. Clearly, as was held in *Jones v. Commissioner, supra,* "the *gratuity* thus bestowed was a *gift.*"

In *Blair v. Rosseter,* 33 Fed. (2d) 286 (C.C.A. 9th Cir., 1929), the taxpayer had been president of a corporation from 1910 to 1920, and during that period was paid an annual salary of $6,000.00 *"in full compensation* for such services." In 1920, the stockholders instructed the Board of Directors to authorize the payment of $50,000.00 to him "as a gift *in recognition of his able and successful direction* of the affairs of the company during the past ten years." In affirming a decision of the Board of Tax Appeals holding such payment to be a gift not subject to income tax, the Court said:

> "A gift is generally defined as a *voluntary* transfer of property by one to another, *without* any *consideration or compensation therefor.* 28 C. J. 620. The payment here in controversy was denominated a gift by both stockholders and directors; it was without consideration or compensation, and we think it must be conceded that it has all the earmarks of a gift or

windfall. The Commissioner seems to contend that there was a consideration for the payment, but manifestly an agreement on the part of a corporation to pay additional compensation to its president for services performed over a period of ten years *for which he had already been fully compensated is without consideration and void.* Alaska Packers' Ass'n v. Domenico (C.C.A.) 117 F. 99.

"If the agreement had remained *executory,* no court would enforce it; if the corporation was *insolvent* at the time, no court would refuse to set the transaction aside at the suit of a creditor or a trustee in bankruptcy, and, if the corporation *had attempted to deduct the amount of the payment from its gross income for tax purposes,* we have little doubt that the government could successfully contest its right to do so. It is said that the corporation paid no income tax for the year in question, but, if that be true, it would in nowise change the nature of the transaction."

33 Fed. (2d) 286-287.

In *Barnes v. Commissioner,* 17 B.T.A. 1002, the payment in question was held to be a *nontaxable gift* notwithstanding the fact that it had been *by the donor denominated "additional compensation,"* the Board of Tax Appeals according recognition to the tendency of the more modern decision,—*e.g.,* the *Jones* and *Rosseter* cases, *supra,*—so to regard payments such as those there involved.

In *Cowen v. Seymour,* [1920] 1 K. B. 500, the payment was made by direction of the *stockholders* of the corporation,—just as, in the case at bar, the sole common

stockholder of Gas Company "arranged" for the payment to Taxpayer. The Court, in the course of an opinion holding the payment in question to be a *nontaxable gift,* said:

> "* * * the fact that the *office* [of the recipient of the payment] *has terminated* is a matter of *very great importance*" [p. 509],

i.e., as indicating that the payment was *not* in respect of such *office,* but as a *solatium* for its *loss.*

This same circumstance is adverted to in *Stedeford v. Beloe,* [1932] A. C. 388, the Master of the Rolls saying:

> "It [the payment] was not given to him *in respect of his office* as headmaster, *because he no longer holds that office* of headmaster." [p. 390]

And, in a concurring opinion, one of the Lords Justice quotes from an earlier opinion of the same Master of the Rolls as follows:

> " 'It was a mere donation [on retirement] given each year with no certioration that it would be repeated in the year following.' " [p. 391]

It will be remembered that the payment in the case at bar was determined upon *in contemplation of the termination of Taxpayer's employment* entailed by the sale of Gas Company's electric properties; that such payment would *not* have been made except for that "abnormal or extraordinary transaction"; and that *no similar payment* was made to the employees who did *not* suffer the *loss of their positions* with Gas Company as a result of that sale.

In *Chibbett v. James Robinson & Sons,* 132 L. T. (N.S.) 26, the Court denominates the payment there in question as *"compensation for loss of office or employment,"*—such loss having been caused by the reorganization of a corporation engaged in ocean transport,—and says:

> "* * * It [the employer] gave this *solatium* to the respondents out of its *abundant prosperity* once and for all, *not* because of anything they *were* doing, but * * * as a *testimonial* for what they *had done in the past in that office which had now terminated."*

There is a very special aptness in the Court's observations last quoted, for it will be recalled that Gas Company's president declared to Taxpayer that the payment to *him,* for which its holding company had "arranged," was "in *recognition* of [his] fine work in the *franchise cases,"*—a matter *past and gone forever* and in its day constituting litigation unique not only in Gas Company's experience but, seemingly, in jurisprudence. Even in the circular letter addressed to the transferred employees by Gas Company's president, the addresses are notified that "the sale of our electric properties to The City of Los Angeles * * * will make it necessary that the people who operate these properties *sever their relations* with Los Angeles Gas and Electric Corporation." The letter then proceeds to express to them "my very great *appreciation* of the *splendid service* you *have* rendered during the past years, and of the fine *support* you *have* given to me and to our management generally *in the conduct of our electric business* * * *." *Arrangements have been made* to grant you additional compensation *in recognition* of the value *of your past services."*

Conclusion.

The facts elicited at the hearing herein, summarized in the opening pages of this brief, and the authorities above cited, demonstrate that the sum of $8,394.92, paid to Taxpayer by his former employer *on the termination of his employment* under the circumstances above set forth, constituted a *nontaxable gift.* Accordingly, the decision of the Board of Tax Appeals holding it to be "compensation", and as such taxable income for the year 1937, is erroneous and should be reversed.

Respectfully submitted,

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